

COTTONWOOD IMPROVEMENT DISTRICT

**FINANCIAL STATEMENTS
with
INDEPENDENT AUDITORS' REPORTS**

DECEMBER 31, 2006

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees
Cottonwood Improvement District
Salt Lake City, Utah

We have audited the accompanying basic financial statements of Cottonwood Improvement District as of and for the year ended December 31, 2006, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of Cottonwood Improvement District as of December 31, 2006, and the results of its operations and the cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated June 1, 2007 on our consideration of Cottonwood Improvement District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis is not a required part of the financial statements, but is supplementary information the Governmental Accounting Standards Board requires. We applied limited procedures, consisting principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion thereon.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of Cottonwood Improvement District. The schedule of impact fees is presented for purposes of additional analysis and is not a required part of the basic financial statements. The schedule of impact fees has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

Pinnock, Robbins, Posey & Richins

June 1, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Cottonwood Improvement District's (the District) annual financial report presents our analysis of the District's financial performance during the year ended December 31, 2006. We encourage readers to consider the information presented here in conjunction with the financial statements and accompanying notes to enhance their understanding of the District's financial activities.

Financial Highlights:

- Operating revenues increased by approximately \$4,200,000 (or 350.9%). This increase is primarily the result of a sewer rate increase from \$3 to \$12 per month per resident or residential equivalent, in order to maintain an appropriate level of cash reserves while making expensive infrastructure replacements and rehabilitation.
- Interest income increased by approximately \$260,000 (or 45.5%) in 2006, attributable to an increase of 1.07% in interest rates over the year applied to an increase of investment funds provided by the sewer service rate increase.
- Operating expenses increased approximately \$595,000 (10.8%), due in most part to increased operation costs of Central Valley Water Reclamation Facility, increased employee costs such as wages and health insurance costs, and also increased depreciation for additions to and rehabilitations of the collection system.
- There were no capital contributions made in the form of sewer lines from developers during 2006, which is a decrease of approximately \$325,000 from the previous year.

Overview of Financial Report:

This annual report consists of two parts: Management's Discussion and Analysis and Financial Statements. The Financial Statements also include notes that explain in more detail some of the information in the financial statements. This report also contains other supplementary information in addition to the financial statements themselves.

The Management's Discussion and Analysis (MD&A) serves as an introduction to the basic financial statements and supplementary information. The MD&A represents management's analysis of the District's financial condition and performance.

The Financial Statements report information about the District using full accrual accounting methods as utilized by similar business activities in the private sector. They include a balance sheet; a statement of revenues, expenses and changes in net assets; a statement of cash flows; and notes to the financial statements. The balance sheet presents the financial position of the District on a full accrual historical cost basis. While the balance sheet provides information about the nature and amount of resources and obligations at year end, the statement of revenues, expenses and changes in net assets presents the results of business activities over the course of the year and information as to how the net assets changed during the year. The statement of cash flows presents changes in cash and cash equivalents, resulting from operating, non-capital and related financing, capital and related financing, and investing activities. In other words, it provides information regarding where the cash came from and how it was used, and the change in cash balance during the reporting period. The notes to the financial statements provide required disclosures and other information that are essential to the full understanding of material data provided in the statements. The notes present information about the District's accounting policies, significant account balances, obligations, commitments, contingencies and subsequent events, if any.

Financial Analysis:

To begin our analysis, a summary of the District's balance sheet is presented in the schedule below. This section will discuss and analyze significant differences between the years ended December 31, 2005 and 2006.

**Cottonwood Improvement District
Balance Sheet**

	<u>2006</u>	<u>2005</u>
Current and Other Assets	\$35,787,426	\$34,625,648
Capital Assets	<u>28,626,575</u>	<u>28,545,524</u>
Total Assets	<u>\$64,414,001</u>	<u>\$63,171,172</u>
Current Liabilities	\$ 1,608,693	\$ 1,737,711
Noncurrent Liabilities	<u>1,877,456</u>	<u>1,408,506</u>
Total Liabilities	<u>3,486,149</u>	<u>3,146,217</u>
Net Assets Invested in Capital Assets, Net of Related Debt	28,626,575	28,545,524
Net Assets Unrestricted	<u>32,301,277</u>	<u>31,479,431</u>
Total Net Assets	<u>60,927,852</u>	<u>60,024,955</u>
Total Liabilities and Net Assets	<u>\$64,414,001</u>	<u>\$63,171,172</u>

The balance sheet includes all of the District's assets and liabilities, and equity which is categorized as either invested in capital assets, net of related debt; restricted; or unrestricted. Net assets may serve as a useful indicator of a government's financial position. As can be seen from the schedule above, assets exceeded liabilities by \$60,927,852 at the end of the year. The portion of the District's net assets, \$28,626,575 (47%), reflects its investment in capital assets (e.g., land, buildings, sewer lines and equipment). The District uses these capital assets in its daily operations; consequently, they are not available for future spending.

While the balance sheet shows the change in financial position of net assets, the summary of the District's statements of revenues, expenses and changes in net assets, provides information regarding the nature and source of these changes as seen in the following schedule. Net assets increased in 2006 by \$902,897 as a result of an increase in the monthly sewer rate from \$3 to \$12 per resident or residential equivalent as of January 1, 2006.

**Cottonwood Improvement District
Condensed Statement of Revenues, Expenses, and Changes in Net Assets**

	<u>2006</u>	<u>2005</u>
Operating Revenues	\$ 5,397,772	\$ 1,197,361
Non-operating Revenues	<u>2,768,867</u>	<u>2,459,052</u>
Total Revenues	<u>8,166,639</u>	<u>3,656,413</u>
Depreciation Expense	1,273,471	1,185,443
Other Operating Expense	4,838,121	4,331,314
Non-operating Expense	<u>1,152,150</u>	<u>1,359,558</u>
Total Expenses	<u>7,263,742</u>	<u>6,876,315</u>
Income/(Loss) Before Capital Contributions	902,897	(3,219,902)
Capital Contributions	<u>—</u>	<u>325,024</u>
Change in Net Assets	902,897	(2,894,878)
Net Assets - Beginning of Year	<u>60,024,955</u>	<u>62,919,833</u>
Net Assets - End of Year	<u>\$60,927,852</u>	<u>\$60,024,955</u>

Capital Assets and Debt Administration:

Capital assets. A review of the schedule below shows that capital assets (net of depreciation) increased \$83,051. The major capital asset events during the year included the following:

- Sewer line and manhole rehabilitations and replacements took place totaling \$1,114,684.
- A van with equipment used to televise sewer lines was replaced at a cost of \$120,000.

Cottonwood Improvement District Capital Assets, Net of Depreciation

	<u>2006</u>	<u>2005</u>
Land and Right of Ways	\$ 1,131,234	\$ 1,131,234
Buildings and Structures	2,490,259	2,726,988
Collections System	24,331,624	23,834,590
Equipment	230,069	265,308
Vehicles	443,903	585,547
Furniture and Fixtures	<u>1,486</u>	<u>1,857</u>
 Total Capital Assets (Net of Depreciation)	 <u>\$28,628,575</u>	 <u>\$28,545,524</u>

Additional information on Cottonwood Improvement District's capital assets can be found in Note 3 on pages 16-17 of this report.

Long-term debt. At the end of the current fiscal year, Cottonwood Improvement District had total bonded debt outstanding in the amount of \$1,946,523, consisting entirely of revenue bonds. This represents Cottonwood Improvement District's portion of revenue bonds issued to Central Valley Water Reclamation Facility and distributed to the District and is the District's obligation. The bonds were issued at 3% for 20 years.

Long-Term Debt

	<u>2006</u>	<u>2005</u>
Revenue bonds	\$ 1,946,523	\$ 1,471,688

Additional information on Cottonwood Improvement District's long-term debt can be found in Note 6 on pages 19-20 of this report.

Reserve and Fee Structure:

The District's sewer system continues to age. One third of the District's approximately 350 miles of sewer lines is approaching 50 years old. Another third is between 35 and 50 years. Over time, the hydrogen sulfide gas (which is produced by sewage in the lines), causes the sewer pipe to deteriorate, which requires the replacement or rehabilitation of the sewer lines.

In order to maintain the appropriate level of cash reserves and cover increased operating expenses and expensive infrastructure replacements and rehabilitation, it was necessary to increase the sewer rate. Effective January 1, 2006 the sewer rate was increased from \$3 to \$12 per month per resident or residential equivalent. Cash reserves are also maintained to provide assets for repairs and reconstruction of the infrastructure in the event of a catastrophic incident, which could affect the District's ability to provide sewer service to its residents. Current cash and cash equivalents available for those reserves at the end of the current fiscal year total \$17,994,806. The tax rate is .000244.

Final Comments:

This financial report is designed to provide taxpayers, customers and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions regarding this report or need additional financial information, contact the Controller of the Cottonwood Improvement District, 8620 Highland Dr., Sandy, Utah 84093 or by phone (801)943-7671.

COTTONWOOD IMPROVEMENT DISTRICT

BALANCE SHEET

DECEMBER 31, 2006

ASSETS

CURRENT ASSETS:

Cash and cash equivalents	\$17,994,806
Receivables:	
Service charges	294,625
Certified service charges	35,803
Connection fees	1,000
Property taxes	28,008
Other	<u>3,667</u>

TOTAL RECEIVABLES 363,103

NOTE RECEIVABLE, CURRENT PORTION 33,471

TOTAL CURRENT ASSETS 18,391,380

RESTRICTED ASSETS:

Escrow - Solitude Improvement District	10,000
Escrow - Fire Station	<u>10,000</u>

TOTAL RESTRICTED ASSETS 20,000

NOTE RECEIVABLE, LONG-TERM PORTION 178,058

CAPITAL ASSETS:

Capital assets not being depreciated	1,131,234
Capital assets being depreciated, net of accumulated depreciation	<u>27,497,341</u>

TOTAL CAPITAL ASSETS 28,628,575

OTHER ASSETS:

Advance to Central Valley Water Reclamation Facility	244,612
Investment in Central Valley Water Reclamation Facility	<u>16,951,376</u>

TOTAL OTHER ASSETS 17,195,988

TOTAL NONCURRENT ASSETS 46,022,621

TOTAL ASSETS \$ 64,414,001

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:

Accounts payable:	
Central Valley Water Reclamation Facility	\$ 208,236
Trade	83,353
Other	53,206
Accrued vacation and sick leave	655,066
Accrual interest payable	39,037
Deferred revenue	480,728
Revenue bonds payable – current	<u>89,067</u>

TOTAL CURRENT LIABILITIES	<u>1,608,693</u>
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LIABILITIES PAYABLE FROM RESTRICTED ASSETS:

Escrow - Fire Station	10,000
Service Escrow – Solitude	<u>10,000</u>

TOTAL LIABILITIES PAYABLE FROM RESTRICTED ASSETS	<u>20,000</u>
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REVENUE BONDS PAYABLE	<u>1,857,456</u>
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TOTAL NONCURRENT LIABILITIES	<u>1,877,456</u>
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TOTAL LIABILITIES	<u>3,486,149</u>
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NET ASSETS:

Invested in capital assets, net of related debt	28,628,575
Unrestricted	<u>32,299,277</u>

TOTAL NET ASSETS	<u>60,927,852</u>
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TOTAL LIABILITIES AND NET ASSETS	<u>\$64,414,001</u>
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COTTONWOOD IMPROVEMENT DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN NET ASSETS
YEAR ENDED DECEMBER 31, 2006

OPERATING REVENUES:	
Charges for services	\$ 5,347,196
Other	<u>50,576</u>
TOTAL OPERATING REVENUES	<u>5,397,772</u>
OPERATING EXPENSES:	
Personal services	2,454,128
Central Valley Water Reclamation Facility Operations	1,591,155
Depreciation	1,273,471
Materials, supplies and repairs	474,220
Other	<u>318,618</u>
TOTAL OPERATING EXPENSES	<u>6,111,592</u>
OPERATING (LOSS)	<u>(713,820)</u>
NON-OPERATING REVENUES (EXPENSES):	
Property taxes	1,522,413
Interest income	832,595
Connection fees	343,962
Gain on disposal of assets	69,897
Equity in net loss of Central Valley Water Reclamation Facility	(1,092,923)
Interest expense	<u>(59,227)</u>
TOTAL NON-OPERATING REVENUES (EXPENSES)	<u>1,616,717</u>
INCOME BEFORE CAPITAL CONTRIBUTIONS	<u>902,897</u>
DEVELOPER CONTRIBUTED SEWER LINES	<u>-</u>
CHANGE IN NET ASSETS	902,897
NET ASSETS - BEGINNING OF YEAR	<u>60,024,955</u>
NET ASSETS - END OF YEAR	<u>\$60,927,852</u>

COTTONWOOD IMPROVEMENT DISTRICT

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2006

CASH FLOWS FROM OPERATING ACTIVITIES:

Receipts from customers and users	\$ 5,314,257
Payments to suppliers	(2,730,139)
Payments to employees	<u>(2,403,112)</u>

NET CASH PROVIDED BY OPERATING ACTIVITIES 181,006

CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:

Property taxes	<u>1,529,116</u>
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NET CASH PROVIDED BY NON-CAPITAL
FINANCING ACTIVITIES 1,529,116

**CASH FLOWS FROM CAPITAL AND RELATED FINANCING
ACTIVITIES:**

Receipts from connection fees	344,642
Acquisition and construction of capital assets	(1,367,371)
Proceeds from bonds issued by Central Valley Water Reclamation Facility	561,244
Interest paid	(59,143)
Principal payments - note receivable	31,526
Principal payments on bonds issued by Central Valley Water Reclamation Facility	(86,409)
Proceeds from sale of capital assets	<u>80,746</u>

NET CASH (USED IN) CAPITAL AND RELATED
FINANCING ACTIVITIES (494,765)

CASH FLOWS FROM INVESTING ACTIVITIES:

Capital acquisitions in Central Valley Water Reclamation Facility	(856,231)
Interest received	<u>832,595</u>

NET CASH (USED IN) INVESTING ACTIVITIES (23,636)

NET INCREASE IN CASH AND CASH EQUIVALENTS 1,191,721

CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR 16,823,085

CASH AND CASH EQUIVALENTS - END OF YEAR \$18,014,806

CASH APPEARS ON THE BALANCE SHEET AS FOLLOWS:

Cash and cash equivalents - unrestricted	\$17,994,806
Cash and cash equivalents - restricted	<u>20,000</u>

\$18,014,806

COTTONWOOD IMPROVEMENT DISTRICT
STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED DECEMBER 31, 2006

RECONCILIATION OF OPERATING (LOSS) TO NET CASH
PROVIDED BY OPERATING ACTIVITIES:

Operating (loss)	\$ (713,820)
Adjustments to reconcile operating (loss) to net cash provided by operating activities:	
Depreciation	1,273,471
Changes in operating assets and liabilities:	
(Increase) decrease in:	
Receivables	(243,658)
Increase (decrease) in:	
Accounts payable	(346,146)
Accrued vacation and sick leave	51,016
Deferred revenue	<u>160,143</u>

NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 181,006</u>
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NON-CASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:

The District recognized its proportionate share of equity in the net loss of Central Valley Water Reclamation Facility in the amount of \$1,092,923 for the year ended December 31, 2006.

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2006

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Cottonwood Improvement District (the District) was created in 1955 and operates under Title 17A-2-301-330 (Utah Code Annotated 1953, as amended). The District is governed by a Board of Trustees comprised of three publicly elected members. The District is a special purpose governmental entity engaged in business-type activities. The District constructs, operates, and maintains sewage systems for the collection, treatment, and disposition of sewage.

The accounting policies of the District conform to generally accepted accounting principles as applicable to governmental units. The following is a summary of the significant accounting policies:

a. Reporting Entity

In determining the reporting entity, the District applied the Criteria of Statement No. 14 of the Government Accounting Standards Board. The underlying concept of Statement No. 14, is that the financial reporting entity consists of the primary government, organizations for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The criteria used for determining financial accountability is whether the District's board appoints a voting majority of the potential component units' (PCU) board, whether the board of the primary government can impose their will on the PCU and whether the PCU imposes a financial benefit or burden on the primary government. Cottonwood Improvement District applied these criteria and concludes there are no potential component units that should be included in the reporting entity. In addition, the District is not reported as a component unit in any other governmental reporting entity.

b. Measurement Focus and Basis of Accounting

The District is an enterprise fund, which is reported using the *economic resources measurement focus* and the *accrual basis of accounting*. An enterprise fund is used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs of providing services to the general public on a continuing basis are financed or recovered primarily through user charges. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, the District applies all GASB pronouncements as well as Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

c. Investments

Investments are carried at cost, which approximates market.

d. Property, Plant, and Equipment

Property, plant, and equipment are stated at cost for assets acquired or constructed. Contributed fixed assets are recorded at estimated fair market value at the time received. Depreciation is provided using the straight-line method over estimated useful lives; 50-66 years for the sewage collection system, 20-33 years for buildings, and 4-17 years for equipment.

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

e. Accrued Vacation and Sick Leave

Benefits for vacation leave are accounted for on the accrual basis. Accrued vacation is accumulated and up to 320 hours may be carried over into the next year. In the event of termination, employees are reimbursed for the entire amount of accumulated vacation. Effective January 1, 2002, the District adopted a new sick leave policy. Employees receive a cash pay out of 25% of unused sick leave earned each year, and the remaining hours are carried over into the next year and may be accumulated up to 1,560 hours. In the event of termination, employees receive no benefit for accrued unused sick leave unless they are retiring. Retiring employees receive a cash pay out of 25% of accumulated sick leave, and the remaining amount will be used to pay for the retiring employees' health insurance premiums.

f. Deferred Revenue

Payments received and billings for service charges made in advance are deferred and recognized as revenue when earned.

g. Property Taxes

The budgeting and accounting for property taxes is accounted for on an accrual basis with appropriate recognition of taxes receivable at year end. The property tax revenue of the District is levied, collected, and distributed by Salt Lake County as required by State law.

Utah statutes establish the process by which taxes are levied and collected. The County Assessor is required to assess real property as of January 1 and complete the tax rolls by May 15. The property taxes attach as an enforceable lien on real property as of January 1. By the third Monday in September, the auditor is to deliver the completed assessment rolls to the County Treasurer. Tax notices are mailed with a due date of November 30. Property tax receivables are recorded as of the date levied (assessed). Personal property taxes are also recorded as receivables and revenues in the accompanying financial statements.

h. Statements of Cash Flow

For purposes of the statements of cash flows, the District considers cash equivalents to be all highly liquid investments with original maturities of three months or less.

2. DEPOSITS AND INVESTMENTS

The State of Utah Money Management Council has the responsibility to advise the State Treasurer about investment policies, promote measures and rules that will assist in strengthening the banking and credit structure of the state and review the rules adopted under the authority of the State of Utah Money Management Act that relate to the deposit and investment of public funds.

The District follows the requirements of the Utah Money Management Act (*Utah Code Annotated 1953*, as amended, Section 51, Chapter 7) in handling its depository and investment transactions. The Act requires the depositing of District funds in a qualified depository. The Act defines a qualified depository as any financial institution whose deposits are insured by an agency of the Federal Government and which has been certified by the State Commissioner of Financial Institutions as meeting the requirements of the Act and adhering to the rules of the Utah Money Management Council.

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

2. DEPOSITS AND INVESTMENTS (CONTINUED)

A. Deposits

	<u>Bank Balances</u>	<u>Book Balances</u>
Cash on hand	\$ —	\$ 200
Cash on deposit	<u>275,138</u>	<u>65,818</u>
 TOTAL	 <u>\$ 275,138</u>	 <u>\$ 66,018</u>

Custodial Credit Risk: Custodial credit risk is the risk that, in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a formal deposit policy for custodial credit risk. The District has funds, deposited in a bank, which are covered up to \$100,000 by federal depository insurance. As of December 31, 2006, the carrying amount of the District's cash was \$66,019. The bank balance was \$275,138, of which \$140,555 was uninsured and uncollateralized.

B. Investments

The Money Management Act defines the types of securities authorized as appropriate investments for the District and the conditions for making investment transactions. Investment transactions may be conducted only through qualified depositories, certified dealers, or directly with issuers of the investment securities.

Statutes authorize the District to invest in negotiable or nonnegotiable deposits of qualified depositories and permitted negotiable depositories; repurchase and reverse repurchase agreements; commercial paper that is classified as "first tier" by two nationally recognized statistical rating organizations, one of which must be Moody's Investors Services or Standard & Poor's; bankers' acceptances; obligations of the United States Treasury, including bills, notes, and bonds; bonds, notes, and other evidence of indebtedness of political subdivisions of the State; fixed rate corporate obligations and variable rate securities rated "A" or higher, or the equivalent of "a" or higher, by two nationally recognized statistical rating organizations; shares or certificates in a money market mutual fund as defined in the Act; and the Utah State Public Treasurer's Investment Fund.

The Utah State Treasurer's Office operates the Public Treasurer's Investment Fund (PTIF). The PTIF is available for investment of funds administered by any Utah public treasurer.

The PTIF is not registered with the SEC as an investment company. The PTIF is authorized and regulated by the Money Management Act, Section 51-7, *Utah Code Annotated, 1953*, as amended. The Act established the Money Management Council, which oversees the activities of the State Treasurer and the PTIF and details the types of authorized investments. Deposits in the PTIF are not insured or otherwise guaranteed by the State of Utah, and participants share proportionally in any realized gains or losses on investments.

The PTIF operates and reports to participants on an amortized cost basis. The income, gains, and losses-net of administration fees, of the PTIF are allocated based upon the participant's average daily balance. The fair value of the PTIF investment pool is approximately equal to the value of the pool shares.

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

2. DEPOSITS AND INVESTMENTS (CONTINUED)

As of December 31, 2006, the District had the following investments and maturities:

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More Than 10
State of Utah Public Treasurer's Investment Fund	\$17,948,788	\$17,948,788	\$ -	\$ -	\$ -

Interest Rate Risk: Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The District's policy for managing its exposure to fair value loss arising from increasing interest rates is to comply with the State's Money Management Act. Section 51-7-11 of the Act requires that the remaining term to maturity of investments may not exceed the period of availability of the funds to be invested. Except for funds of Institutions of Higher Education acquired by gifts, grants, or the corpus of funds functioning as endowments, the Act further limits the remaining term to maturity on all investments in commercial paper, bankers' acceptances, fixed rate negotiable deposits, and fixed rate corporate obligations to 270-365 days or less. In addition, variable rate negotiable deposits and variable rate securities may not have a remaining term to final maturity exceeding two years.

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The District's policy for reducing its exposure to credit risk is to comply with the State's Money Management Act as previously discussed. As of December 31, 2006, the District's investments in the State of Utah Public Treasurer's Investment Fund were unrated.

Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The District's policy for reducing the risk of loss is to comply with the Rules of the Money Management Council. Rule 17 of the Money Management Council limits investments in a single issuer of commercial paper and corporate obligations to 5%-10% depending upon total dollar amount held in the portfolio.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The District does not have a formal policy for custodial credit risk.

3. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2006 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 1,131,234	\$ -	\$ -	\$ 1,131,234
Total capital assets, not being depreciated	1,131,234	-	-	1,131,234

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

3. CAPITAL ASSETS (CONTINUED)

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets being depreciated:				
Buildings and structures	\$ 4,891,415	\$ 5,662	\$ —	\$ 4,897,077
Collection system	34,861,795	1,114,684	—	35,976,479
Equipment	1,438,562	80,471	(148,079)	1,370,954
Autos and trucks	1,709,404	166,555	(247,882)	1,628,077
Furniture	28,401	—	—	28,401
Total capital assets being depreciated	<u>42,929,577</u>	<u>1,367,372</u>	<u>(395,961)</u>	<u>43,900,988</u>
Less accumulated depreciation for:				
Buildings and structures	(2,164,427)	(242,391)	—	(2,406,818)
Collection system	(11,027,205)	(617,650)	—	(11,644,855)
Equipment	(1,173,253)	(109,608)	141,976	(1,140,885)
Autos and trucks	(1,123,858)	(303,451)	243,135	(1,184,174)
Furniture	(26,544)	(371)	—	(26,915)
Total accumulated depreciation	<u>(15,515,287)</u>	<u>(1,273,471)</u>	<u>385,111</u>	<u>(16,403,647)</u>
Total capital assets, being depreciated, net	<u>27,414,290</u>	<u>93,901</u>	<u>(10,850)</u>	<u>27,497,341</u>
CAPITAL ASSETS, NET	<u>\$28,545,524</u>	<u>\$ 93,901</u>	<u>\$ (10,850)</u>	<u>\$28,628,575</u>

4. CENTRAL VALLEY WATER RECLAMATION FACILITY

During 1978, pursuant to the Interlocal Cooperation Act of the State of Utah, the District entered into a joint venture with four other special districts and two other cities. The Central Valley Water Reclamation Facility (Central Valley) was organized to construct and operate a regional sewage treatment facility, for the benefit of the seven members. The seven members and their related ownership interest, as of December 31, 2006 are as follows:

	<u>Original Facility</u>	<u>New Expansion</u>	<u>Enhancements</u>	<u>Digesters</u>	<u>Secondaries</u>
Cottonwood Improvement District	19.569%	7.3215%	18.1191%	8.042%	7.1225%
Salt Lake City Suburban Sanitary District #1	25.622	23.6177	24.7780	20.080	22.6557
Granger-Hunter Improvement District	21.124	25.4755	20.2376	25.050	24.9005
Kearns Improvement District	5.978	24.0002	11.2654	28.435	25.7112
Murray City	8.892	6.8421	8.0168	6.280	6.6882
South Salt Lake City	6.120	2.5074	5.0980	1.378	2.5857
Taylorsville-Bennion Improvement District	<u>12.695</u>	<u>10.2356</u>	<u>12.4851</u>	<u>10.735</u>	<u>10.3362</u>
	<u>100.000%</u>	<u>100.0000%</u>	<u>100.0000%</u>	<u>100.000%</u>	<u>100.0000%</u>

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

4. CENTRAL VALLEY WATER RECLAMATION FACILITY (CONTINUED)

The joint venture is administered by a joint administration board. Each member appoints one member to the board, and voting power is not related to ownership. Therefore, each member is equal to another for voting privileges. The joint venture is responsible for adopting a budget and financing its operations, subject to the approval by each of the seven members.

The District accounts for its investment in Central Valley using the equity method of accounting. Summarized financial information of Central Valley as of December 31, 2006 and for the year then ended is as follows (in thousands):

	<u>2006</u>
Total assets	\$ 139,687
Total net assets	106,890
Revenue	10,366
Change in net assets	2,693
The District's interest in:	
Equity	16,951
Net loss	(1,093)

The District has recorded in prior years its previous proportionate share (19.569%) of the government grants received by Central Valley as an addition to the District's investments in Central Valley. All expenses (except depreciation) incurred by Central Valley are billed to its members. Accordingly, the District's equity in net losses of Central Valley annually approximates its share of Central Valley's depreciation expense. Audited statements are available at Central Valley Water Reclamation Facility, 800 West Central Valley Road, Salt Lake City, UT 84119.

The District incurred the following costs from the joint venture for the years ended December 31, 2006:

	<u>2006</u>
ADMINISTRATION, OPERATIONS AND MAINTENANCE	<u>\$ 1,591,155</u>
TOTAL EQUITY INVESTMENT IN CENTRAL VALLEY WATER RECLAMATION FACILITY	<u>\$16,951,376</u>

5. NOTE RECEIVABLE

The note receivable consists of an amount due from Central Valley for a land purchase in 2002. At the time of the purchase, the District had a 14.87% interest in the land and Central Valley has an 85.13% interest. The note receivable bears interest at 6%, is payable in monthly installments over ten years. Beginning on September 1, 2002, and each year thereafter on the anniversary of the beginning date, Central Valley will acquire 1.487% of the interest of the District in the land until all of the District's interest is transferred to Central Valley at the end of the term of the note.

	<u>2006</u>
Total note receivable	\$ 211,529
Less: current portion	<u>(33,471)</u>
Note receivable, long-term portion	<u>\$ 178,058</u>

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

5. NOTE RECEIVABLE (CONTINUED)

Presented below is a summary of note receivable payment requirements to maturity by years:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 33,471	\$ 11,781	\$ 45,252
2008	35,535	9,717	45,252
2009	37,727	7,525	45,252
2010	40,054	5,198	45,252
2011	42,524	2,728	45,252
Thereafter	<u>22,218</u>	<u>390</u>	<u>22,608</u>
TOTAL	<u>\$ 211,529</u>	<u>\$ 37,339</u>	<u>\$ 248,868</u>

6. LONG-TERM DEBT

Revenue Bonds

The government issues bonds where the government pledges income derived from the acquired or constructed assets to pay debt service. Central Valley Water Reclamation Facility has issued taxable sewer revenue bonds totaling \$35,000,000 at 3% for a term of 20 years, to fund the post-1993 ownership of the treatment facility. Cottonwood Improvement District's share of the bonds is \$2,326,388.

Although the revenue bonds are in the name of Central Valley Water Reclamation Facility, the members are responsible to fund debt service requirements over the life of the bonds. The amount distributed to members in the previous year was \$23,000,000. The remaining bond funds drawn down as of December 31, 2006 (\$7,585,000) were used to fund a Central Valley project and have become the members' obligation. Cottonwood Improvement District's share of the \$23,000,000 bond distributed is \$1,471,688, and its share of the additional draw down of \$7,585,000 is \$561,244.

Revenue bond debt service requirements to maturity are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total Debt Service</u>
2007	\$ 89,067	\$ 58,396	\$ 147,463
2008	89,732	55,724	145,456
2009	91,061	53,032	144,093
2010	96,379	50,300	146,679
2011	99,703	47,408	147,111
2012-2016	538,393	190,561	728,954
2017-2025	<u>942,188</u>	<u>121,975</u>	<u>1,064,163</u>
TOTAL	<u>\$ 1,946,523</u>	<u>\$ 577,396</u>	<u>\$ 2,523,919</u>

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

6. LONG-TERM DEBT (CONTINUED)

Long-term debt activity for the year ended December 31, 2006, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Revenue Bonds	\$ 1,471,688	\$ 561,244	\$ (86,409)	\$ 1,946,523	\$ 89,067
TOTAL BONDS PAYABLE	\$ 1,471,688	\$ 561,244	\$ (86,409)	\$ 1,946,523	\$ 89,067

Total interest expense incurred on long-term debt for the year ended December 31, 2006 was \$59,227, of which none was capitalized.

7. DESIGNATED NET ASSETS

The Board of Trustees of the District has designated unrestricted net assets as of December 31, 2006 for the future capital projects as follows:

	<u>2006</u>
Central Valley Water Reclamation Facility investment and expansion	\$19,930,777
Capital Construction Projects	<u>12,368,500</u>
TOTAL	<u>\$32,299,277</u>

8. EMPLOYEE RETIREMENT PLANS

Plan Description

The Cottonwood Improvement District contributes to the Local Governmental Noncontributory Retirement System, which is administered by the Utah Retirement Systems (Systems), a cost-sharing multiple-employer defined benefit pension plan. Utah Retirement Systems provide refunds, retirement benefits, annual cost of living adjustments, and death benefits to plan members and beneficiaries in accordance with retirement statutes.

The Systems are established and governed by the respective sections of Chapter 49 of the Utah Code Annotated 1953 as amended. The Utah State Retirement Office Act in Chapter 49 provides for the administration of the Utah Retirement Systems and Plans under the direction of the Utah State Retirement Board (Board) whose members are appointed by the Governor. The Systems issue a publicly available financial report that includes financial statements and required supplementary information. A copy of the report may be obtained by writing to the Utah Retirement systems, 540 East 200 South, Salt Lake City, UT 84102 or by calling (800) 365-8772.

Funding Policy

In the Local Governmental Noncontributory Retirement System, the Cottonwood Improvement District was required to contribute 11.09%, January 2006 through June 2006, and 11.59% July 2006 through December 2006, of their annual covered salary for 2006. The contribution rates are the actuarially determined rates. The contribution requirements of the Systems are authorized by statute and specified by the Board.

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

8. EMPLOYEE RETIREMENT PLANS (CONTINUED)

The Cottonwood Improvement District contributions to the Local Governmental Noncontributory Retirements system for December 31, 2006, 2005, and 2004 were \$175,763, \$156,713, and \$129,042, respectively. The contributions were equal to the required contributions for each year.

The District's full time employees also participate in the 401(k) plan and the 457 plan administered by the System. The 2006, 2005, and 2004 employee contributions to the 401(k) plan were \$54,392, \$48,747, and \$37,720 respectively. The 2006, 2005, and 2004 employee contributions to the 457 plan were \$2,450, \$40, and \$0 respectively. The District made no contribution to either plan during 2006, 2005, and 2004.

9. PROPERTY TAX REVENUE

The District's total tax rate is .000244. The entire amount is used to meet operating and maintenance expenses. Property tax revenue for the year ended December 31, 2006 was \$1,522,413, and includes \$130,726 for motor vehicle fee-in-lieu of taxes.

10. COMMITMENTS

During 2006, the District entered into a contract to purchase two manhole service trucks with compressors and two small dump trucks at a cost totaling \$299,932. Subsequent to 2006, these trucks were received and placed into service.

11. IMPACT FEES

The District collects connection fees that are defined as impact fees. The District must expend these impact fees on capital expenditures relating to the infrastructure of the District, Central Valley Water Reclamation Facility construction, or building improvements. As allowed by law, the District's policy is to reimburse prior infrastructure costs before current expenditures. Therefore, the District had no impact fee reserves at December 31, 2006. Revenues from impact fees were \$343,962 for the year ended December 31, 2006.

OTHER SUPPLEMENTARY INFORMATION

COTTONWOOD IMPROVEMENT DISTRICT

SCHEDULE OF IMPACT FEES

FOR THE YEAR ENDED DECEMBER 31, 2006

Cottonwood Improvement District collects wastewater impact fees. The following is a recap of the impact fees outstanding by year of collection:

<u>Year Collected</u>	<u>Wastewater</u>
2006	\$ —
TOTAL	\$ —

The following capital projects are planned to use the impact fees shown above:

<u>Planned Capital Project</u>	<u>Projected Cost</u>	<u>Anticipated Start Date</u>
Union Park Avenue Line Replacement	\$ 1,725,000	2007
Willow Creek Dr. Line Upsize	\$ 234,000	2007
Robideux Road Line Upsize	\$ 208,000	2007
1300 East Line Rehabilitation	\$ 645,500	2007
Miscellaneous Line Repairs & Lining	\$ 560,000	2007
Bengal Blvd. Line Upsize	\$ 658,000	2008
8600 South Line Upsize	\$ 660,000	2008
Mick Reily Line Rehabilitation	\$ 154,000	2008
Miscellaneous Line Repairs & Lining	\$ 302,500	2008
Trans Highland Drive Line Replacement	\$ 130,000	2009
900 East, 5200 So to Vine Line Rehab	\$ 384,000	2009
Miscellaneous Line Repairs & Lining	\$ 302,500	2009
7000 South Line Upsize	\$ 1,325,000	2010
Big Cottonwood Creek Road Rehab.	\$ 140,000	2010
Miscellaneous Line Repairs & Lining	\$ 325,000	2010
Union Park Upsize	\$ 315,000	2011
Gordon Lane Rehabilitation	\$ 558,000	2011
Miscellaneous Line Repairs & Lining	\$ 325,000	2011



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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Trustees
Cottonwood Improvement District

We have audited the financial statements of Cottonwood Improvement District as of and for the year ended December 31, 2006, and have issued our report thereon dated June 1, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Cottonwood Improvement District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider certain deficiencies described in the accompanying management letter to be significant deficiencies in internal control over financial reporting (items 1 through 2).

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. We did not consider either of the items mentioned in the accompanying management letter to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Cottonwood Improvement District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of the Board of Trustees, management, and applicable regulatory agencies, and is not intended to be and should not be used by anyone other than these specified parties.

Pinnock, Robbins, Posey & Richins

June 1, 2007



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INDEPENDENT AUDITORS' REPORT ON STATE LEGAL COMPLIANCE

To the Board of Directors
Cottonwood Improvement District

We have audited the financial statements of Cottonwood Improvement District, for the year ended December 31, 2006 and have issued our report thereon dated June 1, 2007. Our audit included test work on the District's compliance with those general compliance requirements identified in the State of Utah Legal Compliance Audit Guide, including:

Cash Management
Purchasing Requirements
Budgetary Compliance
Truth in Taxation

Other Compliance Requirements
Special Districts
Impact Fees

The District did not receive any major or nonmajor State grants during the year ended December 31, 2006.

The management of Cottonwood Improvement District is responsible for the District's compliance with all compliance requirements identified above. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

The results of our audit procedures disclosed no instances of noncompliance with the requirements referred to above.

In our opinion, Cottonwood Improvement District, complied, in all material respects, with the general compliance requirements identified above for the year ended December 31, 2006.

This report is intended for the use of Cottonwood Improvement District's Management, Board of Directors, and applicable federal and state agencies. However, this report is a matter of public record and its distribution is not limited.

Pinnock, Robbins, Posey & Richins

June 1, 2007

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June 1, 2007

To the Board of Trustees
Cottonwood Improvement District

As part of our audit of the financial statements of Cottonwood Improvement District (the District), professional standards require that we communicate, in writing, deficiencies in internal control over financial reporting (internal control) that rise to the level of "significant deficiencies" or "material weaknesses" that we identified during our audit of the financial statements.

As we previously discussed, these deficiencies must be communicated even though management may already know about them and may have made a conscious decision to accept these risks because of cost or other considerations. Also, the independent auditor cannot be used as an internal control to overcome internal control deficiencies. With this in mind we are communicating the following matters.

In planning and performing our audit of the financial statements of the District as of and for the year ended December 31, 2006, in accordance with auditing standards generally accepted in the United States of America, we considered the District's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that we consider to be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

SIGNIFICANT DEFICIENCIES

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiencies to be significant deficiencies in internal control:

1. Segregation of Duties

We noted during our audit a deficiency in the operation of controls to ensure adequate segregation of duties in the cash receipts function. The same employees have custody of cash, can approve transactions, and perform general ledger maintenance, and there is a lack of management oversight over this function.

Management's Response

Management acknowledges the problem regarding adequate segregation of duties and has reassigning duties to remedy the deficiency.

2. Recording of Commitments

We noted during our audit a deficiency in the design of controls to ensure proper recording of liabilities. Liabilities have largely been recorded when a purchase order is remitted to a vendor for goods or services rather than when the invoice is received.

Management's Response

Management concurs with the internal control finding that liabilities have been recorded when the commitment to purchase goods or services, and has adopted the practice of recording the asset or expense and corresponding liability, only after the receipt of the goods or services.

MATERIAL WEAKNESSES

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We did not become aware of any deficiencies that we considered to be material weaknesses in internal control.

* * * * *

Cottonwood Improvement District's written responses to the significant deficiencies identified in our audit have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management, the Board of Trustees, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Pinnock, Robbins, Posey & Richins

PINNOCK, ROBBINS, POSEY & RICHINS, PC